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7 and **Crafty Productions, LLC**

8 **UNITED STATES DISTRICT COURT**
9 **SOUTHERN DISTRICT OF CALIFORNIA**
10

11 **Crafty Productions, Inc.**, a California
corporation, and **Crafty Productions,**
12 **LLC**, a California company,

13 Plaintiffs,

14 v.

15 **Fuqing Sanxing Crafts Co. Ltd.**, a
China company, **Tony Zhu**, an
16 individual, **Michelle Faherty d/b/a**
MRF Associates, an individual, **The**
17 **Michaels Companies, Inc.**, a Delaware
corporation, **Michaels Stores, Inc.**, a
18 Delaware corporation, **Plaid**
Enterprises, Inc., a Georgia
19 corporation, **Hobby Lobby Stores,**
Inc., an Oklahoma corporation, **Sbars,**
20 **Inc.**, a New Jersey corporation, **A.C.**
Moore Arts & Crafts, Inc., a New
21 Jersey corporation, **99 Cents Only**
Stores LLC, a California company,
22 **Dollar Tree Stores, Inc.**, a Virginia
corporation, **Jo-Ann Stores, LLC**, an
23 Ohio company, **Party City Holdings,**
Inc., a Delaware corporation, **Party**
24 **City Corporation**, a Delaware
corporation, **ZheJiang HongYe Co.**
25 **Ltd.**, a China company, **Fuzhou Bomy**
Trading Co., Ltd., a China company,
26 **Fuzhou Great Suns Co. Ltd.**, a China
company, **Sunface Crafts Co. Ltd.**, a
27 China company,

28 Defendants.

Case No. 3:15-cv-00719-BAS-JLB

PLAINTIFFS' OPPOSITION TO
DEFENDANT FUQING'S
MOTIONS TO COMPEL
ARBITRATION, TO DISMISS,
AND TO DISQUALIFY COUNSEL

(ECF Dkt. Nos. 84 and 89)

Date: November 23, 2015
Ctrm: 4B

Honorable Cynthia Bashant

NO ORAL ARGUMENT UNLESS
REQUESTED BY THE COURT

Introduction and Factual Background¹

As Plaintiffs set forth in detail in their Complaint and First Amended Complaint, this case is about a local San Diego company—Plaintiff Crafty Productions, Inc. (“CPI”)—who created many of the “crafty” products sold to American consumers in a successful segment of the crafts market. CPI essentially pioneered this particular segment of the market over a decade ago. For many years thereafter, CPI had its crafty creations manufactured in China, and CPI sold them to the large crafts retailers in the United States. Several years ago, however, in an effort to cut costs and increase profits on both ends, the manufacturers in China and the large U.S. retailers got together directly, diverting business away from CPI while continuing to manufacture and sell—*en masse*—CPI’s many original, creative designs. Because CPI is a small company, it remained ignorant until its sales dropped so precipitously it has now become barely viable. In their move toward “going factory direct,” as it is called, everyone intentionally ignored CPI’s intellectual property rights, which is the wrong this action was brought to make right. *See generally* ECF No. 72 (First Amended Complaint).

Defendant Tony Zhu (“Zhu”) is the President and sole “principal” of the first-named Defendant Fuqing Sanxing Crafts Co. Ltd. (“Fuqing”) of China, which is one of the many “two-timing” manufacturers. In an effort to incent Fuqing and Zhu to cease the alleged infringement and begin to conduct their business with CPI with honesty and integrity, CPI and Fuqing entered into several agreements starting in 2012, and formed an LLC together in 2014. First, in June 2012, Zhu and others

¹ Plaintiffs recognize this Court’s mandate, from Paragraph D of the Standing Order, that “[i]f multiple parties are moving for substantially the same relief or opposing a motion seeking substantially the same relief sought against them, and noticed for the same hearing date, counsel shall make every effort to coordinate and consolidate the briefing” Plaintiffs have attempted to consolidate their opposition papers addressing similar issues and/or responding to the motions from particular parties, which were filed without a reciprocal effort at consolidation.

1 signed a non-disclosure agreement concerning CPI's proprietary and/or confidential
2 information. *See* ECF No. 72 at 9 ¶ 35, Ex. J (ECF No. 72-11). Next, in connection
3 with CPI's intent to find a buyer for the company, Zhu and others signed a second,
4 more robust non-disclosure agreement on October 9, 2012. *See* ECF No. 72 at 9 ¶
5 38. This agreement includes a prohibition on selling CPI's original designs and
6 products to CPI's competitors, and mandates that any dispute be governed by
7 California law and resolved in San Diego. *See* ECF No. 72-13 at 7. CPI's claims in
8 this action include claims against Fuqing, Zhu and Faherty for breaches of these
9 non-disclosure agreements. *See* ECF No. 72 at 22-23.

10 Next, CPI and Fuqing formed Crafty Productions, LLC ("CPL"), with CPI as
11 the majority owner and Paula Mello as the Manager. *See* ECF No. 72-16. The
12 LLC's Operating Agreement forms no basis for any claim asserted in this action. A
13 separate Contribution Agreement dated February 11, 2014, however, required
14 Fuqing to contribute \$100,000 to CPL on or before December 1, 2014, and the
15 agreement is governed by California law. *See* ECF No. 72-15 at 5. The agreed
16 payment is now past due, and Fuqing is therefore in material breach of the
17 Contribution Agreement, which claim is asserted by CPL in this action. *See* ECF
18 No. 72 at 22-23. In a separate Consulting Agreement, also governed by California
19 law, Fuqing agreed to pay CPI "a consulting fee of \$100,000.00 . . . commencing on
20 March 1, 2015, and on the 1st day of each year thereafter." *See* ECF No. 72-17 at 3.
21 Because the March 1, 2015 payment is past due, Fuqing is now in material breach of
22 the Consulting Agreement, which claim is asserted by CPI in this action. *See* ECF
23 No. 72 at 22-23.

24 Once it became clear to CPI and CPL that Fuqing and Zhu had no intention to
25 cease their infringement or honor their agreements, Paula Mello (as President of
26 CPI, and as Manager of CPL) hired the undersigned counsel and authorized the
27 filing of the original Complaint in this action, on behalf of both Plaintiffs jointly, on
28

1 April 1, 2015.² The next day, Fuqing filed its own suit against CPI, CPL, and Paula
2 Mello in San Diego Superior Court, asserting claims concerning the same
3 agreements and transactions. *See* Lobbin Decl. ¶ 3; *see also* ECF No. 4 (Notice of
4 Related Case).

5 **No Arbitration Of Any Asserted Claim Is Required**

6 In its motion requesting arbitration, Fuqing’s argument is based entirely on
7 Article 14 of the March 1, 2014 Operating Agreement between Plaintiff CPL,
8 Plaintiff CPI and Defendant Fuqing, which states: “Arbitration constitutes the sole
9 and exclusive remedy for the settlement of any dispute or controversy *concerning*
10 *this Agreement* or the rights of the parties under this Agreement” ECF No. 72-
11 16 at 14 (emphasis added). Just a few lines down the same page, however, Article
12 15.5 requires, “All actions and proceedings arising in connection with this
13 Agreement must be tried and litigated exclusively *in the State and Federal courts*
14 *located in the County of San Diego* . . . ,” so it is not clear whether and when
15 arbitration is ever mandated. *See id.* (emphasis added). Nonetheless, as noted with
16 emphasis, the arbitration provision could apply, by its express terms, only to a
17 dispute concerning the Operating Agreement itself, not concerning any other
18 agreement or contract or tort action or claim, etc.

19 In this action, Plaintiffs have asserted eight claims, none of which assert,
20 invoke, or even require reference to the Operating Agreement. As the First Claim,
21 Plaintiff CPI asserts copyright infringement against each Defendant, which claim
22 covers infringing acts committed within the limitations period under the Copyright
23 Act, including back to 2012 and long before the March 2014 Operating Agreement
24 even existed. *See* ECF No. 72 at 16-17. Plaintiff CPL is not a party to the First
25 Claim, because even after the time CPL was formed, CPI specifically and explicitly
26 retained “all of its rights to pursue IP infringement claims against third parties and

27 ² Both CPI and CPL gave their informed written consent to the joint representation,
28 which Plaintiffs could produce to this Court *in camera*, if necessary.

1 such rights will not be transferred or contributed to [CPL].” *See* ECF No. 72-15 at 8
2 (Contribution Agreement). Therefore, obviously the asserted infringing acts by
3 Fuqing and others occurring before March 1, 2014 remain outside any agreement,
4 particularly the un-asserted Operating Agreement mentioning possible arbitration.
5 As the Second and Third Claims, Plaintiff CPI asserts trade dress infringement
6 under federal and state law against each Defendant, which claims again cover
7 infringing acts committed within the limitations period, including long before the
8 March 2014 Operating Agreement. *See* ECF No. 72 at 17-20. As the Fourth and
9 Fifth Claims, Plaintiff CPI asserts intentional interference with prospective
10 economic advantage, and unfair competition, under state law against each
11 Defendant, which again covers acts committed long before the March 2014
12 Operating Agreement. *See* ECF No. 72 at 20-22.

13 As the Sixth Claim (which could have been pled as two or three separate
14 claims), Plaintiff CPL asserts that Defendant Fuqing breached the Contribution
15 Agreement, and Plaintiff CPI asserts that Defendant Fuqing breached the Consulting
16 Agreement, stated as follows:

17 95. Fuqing has paid no royalties to CPL, in material breach of the
18 Contribution Agreement.

19 96. Fuqing has failed to pay CPL the \$100,000.00 due December 1,
20 2014, in material breach of the Contribution Agreement.

21 97. Fuqing has failed to pay CPI the \$100,000.00 due March 1, 2015,
in material breach of the Consulting Agreement.

22 ECF No. 72 at 22. As the Seventh Claim, Plaintiff CPI alleges that Defendants Zhu
23 and Faherty breached their non-disclosure agreements with CPI. *See* ECF No. 72 at
24 23. As the Eighth Claim, Plaintiff CPI alleges that Defendants Fuqing, Zhu and
25 Faherty committed fraud in their dealings with CPI. *See* ECF No. 72 at 24.

26 As this Court explained recently in the case of *Fagerstrom v. Amazon.com,*
27 *Inc.*, 2015 WL 6393948, at *3 (S.D. Cal. Oct. 21, 2015) (Bashant, J.), “[T]he court’s
28 role under the FAA is limited to determining (1) whether a valid arbitration

1 agreement exists and, if so, (2) whether the scope of the agreement encompasses the
2 dispute at issue.” *Id.* (citing *Chiron Corp. v. Ortho Diagnostic Sys., Inc.*, 207 F.3d
3 1126, 1130 (9th Cir. 2000)). Here, the answer to the first question should be “no,”
4 because Article 14 of the Operating Agreement conflicts with Article 15.5, which
5 requires, “All actions and proceedings arising in connection with this Agreement
6 ***must be tried and litigated exclusively in the State and Federal courts*** located in
7 the County of San Diego” *See* ECF No. 72-16 at 14 (emphasis added). In the
8 case of such a conflict between arbitration and litigation, some courts have
9 appropriately declined to force arbitration. *See, e.g., Applied Energetics, Inc. v.*
10 *Newoak Capital Markets, LLC*, 645 F.3d 522, 525 (2d Cir. 2011).

11 More important is the second question, which also requires a “no” answer
12 because no claim in this action depends in any way on the Operating Agreement.
13 Plaintiffs’ First through Fifth and Eighth claims do not involve or invoke any
14 agreements or contracts whatsoever. The Sixth Claim invokes the separate
15 Contribution Agreement between Plaintiffs and Defendant Fuqing, which confirms
16 in Paragraph 3.6 that it “constitutes the entire agreement between the parties with
17 respect to the transactions contemplated hereby and thereby,” which means the
18 provisions of the Operating Agreement have no governance over the Contribution
19 Agreement. *See* ECF No. 72-15 at 5. The same is true for the Consulting
20 Agreement between CPI and Fuqing (also asserted in the Sixth Claim), which states
21 in Paragraph 8 that it “constitutes the complete understanding and cancels and
22 supersedes any and all other or prior agreements and understandings, whether oral
23 or written, between the parties” ECF No. 72-17 a 3. The Seventh Claim
24 asserts the 2012 non-disclosure agreements, which could not possibly be subject to a
25 2014 arbitration clause in an unrelated agreement. Finally, even if the arbitration
26 provision could apply to some small portion of this action, Fuqing indeed waived
27 any right to force arbitration by filing suit in San Diego Superior Court, which
28 forced CPI to expend resources and file a motion asking the Superior Court to stay

1 the case in favor of this one in federal court. *See, e.g., PPG Indus., Inc. v. Webster*
2 *Auto Parts, Inc.*, 128 F.3d 103, 108-09 (2d Cir. 1997) (finding waiver where party
3 engaged in discovery and filed substantive motions in related action).

4 **No Dismissal Of Claims Is Warranted**

5 As its motion to dismiss, Defendant Fuqing presents a confusing argument
6 that because “Plaintiff CPI and Defendant Fuqing are the only members of [the
7 LLC] Plaintiff CPL,” this means that “CPI is attempting to bring both direct and
8 derivative actions against Defendants—which is not allowed under California law.”
9 ECF No. 89-2 at 4. The central flaw with this argument for dismissal is that it relies
10 on a mistaken premise, which is that “[p]ursuant to the Contribution Agreement, . . .
11 the alleged injuries, such as copyright infringement, run to the LLC, not to Plaintiff
12 CPI in its individual capacity.” *Id.* at 6.

13 But the Contribution Agreement dictates the exact opposite, specifically:

14 Crafty Production, Inc. will reserve and maintain all of its rights to
15 pursue IP infringement claims against third parties and such rights will
not be transferred or contributed to Crafty Production LLC.

16 ECF No. 72-15 at 8. This portion of the agreement is not unclear or ambiguous, and
17 its import confirms that *all claims in this action are CPI’s direct claims*, not
18 derivative, with the exception of one claim—that is, the Sixth Claim which includes
19 a direct claim by Plaintiff CPL asserting that Defendant Fuqing breached the
20 Contribution Agreement. *See* ECF No. 72 at 22 (Paragraphs 95-96). Moreover, the
21 Contribution Agreement was entered only as of March 1, 2014, which means that
22 only CPI (not CPL) could have any claim—for anything—before then. Therefore,
23 all claims in this action are direct (none are derivative), which defeats Fuqing’s
24 argument for dismissal.

25 **No Consideration Of Disqualification Applies**

26 Motions to disqualify counsel “are strongly disfavored.” *Visa U.S.A., Inc. v.*
27 *First Data Corp.*, 241 F. Supp. 2d 1100 (N.D. Cal. 2003) (applying California law).

1 “A motion for disqualification of counsel is a drastic measure which courts should
2 hesitate to impose except when of absolute necessity. They are often tactically
3 motivated; they tend to derail the efficient progress of litigation.” *Id.* (citation
4 omitted). In fact, motions to disqualify counsel “often pose the very threat to the
5 integrity of the judicial process that they purport to prevent.” *Gregori v. Bank of*
6 *Am.* (1989) 207 Cal. App. 3d 291, 300-01. Where an attorney or party files a
7 motion to disqualify counsel in order to delay the litigation or intimidate the
8 adversary, the attorney and/or the party should be sanctioned. *Id.*

9 Fuqing’s argument for disqualification fails because of the same flawed
10 premise about “derivative” claims, of which there are none here. Moreover, as
11 Fuqing states its position, Plaintiffs’ counsel should be disqualified because
12 “California Rule of Professional Conduct 3.310(C)(3) prohibits the representation of
13 two clients whose interests are adverse, without written informed consent.” ECF
14 No. 89-2 at 9-10. The additional flaws of Fuqing’s position include that (a) CPI and
15 CPL have provided informed written consent,³ and (b) CPI and CPL have no
16 adverse interests. As discussed above, Plaintiff CPL has asserted only two claims in
17 this action; first, that “Fuqing has paid no royalties to CPL, in material breach of the
18 Contribution Agreement,” and second, that “Fuqing has failed to pay CPL the
19 \$100,000.00 due December 1, 2014, in material breach of the Contribution
20 Agreement.” ECF No. 72 at 22. These claims present no possibility of any interest
21 adverse to CPI, because as the majority member of CPL, CPI has the identical
22 interest as CPL on these claims—that is, to ensure that minority member Fuqing
23 lives up to its payment obligations to CPL.⁴

24 _____
25 ³ As indicated previously herein, through their non-party principal Paula Mello,
26 both CPI and CPL gave their informed written consent to the joint representation,
27 which Plaintiffs could produce to this Court *in camera*, if necessary.

28 ⁴ Even if there was a plausible conflict issue to address, under Rule 3-600(E) of the
California Rules of Professional Conduct, an attorney “representing an organization

Conclusion

For each of the foregoing reasons, Plaintiffs respectfully submit that Fuqing's motions should all be denied.

Respectfully submitted,

Dated: November 9, 2015

ONE LLP

By: /s/ Stephen M. Lobbin
**Attorneys for Plaintiff Crafty
Productions, Inc. and Crafty
Productions, LLC**

may also represent any of its directors, officers, employees, members, shareholders, or other constituents, subject to the provisions of Rule 3-310." And if the joint representation creates potential or actual conflicts of interest, an organization can consent to the joint representation through "an appropriate constituent of the organization other than the individual or constituent who is to be represented, or by the shareholder(s) or organization members." *Id.* Based on these rules, it is clear that a law firm may "simultaneously represent two adverse clients if full disclosure of the situation is made to both clients and both agree in writing to waive the conflict." *Visa U.S.A.*, 241 F. Supp. 2d at 1104. As discussed, both CPI and CPL already have given their informed written consent.

CERTIFICATE OF SERVICE

I hereby certify that on November 9, 2015, I electronically transmitted the foregoing document using the CM/ECF system for filing, which will transmit the document electronically to all registered participants as identified on the Notice of Electronic Filing, and paper copies have been served on those indicated as non-registered participants.

/s/ Stephen M. Lobbin